UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

# THE LEAST DEVELOPED COUNTRIES REPORT 2010

*Towards a New International Development Architecture for LDCs*

## OVERVIEW

by the Secretary-General of UNCTAD

UNITED NATIONS

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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

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The Overview contained herein is also issued as part of *The least Developed Countries Report 2010* (UNCTAD/LDC/2010), sales no. E.10.II.D.5).

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UNCTAD/LDC/2010 (Overview)

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# INTRODUCTION

Over the past three decades, the LDCs have been following a development strategy designed to release the creative potential of market forces by reducing the role of the State in the development process. For the first two of those decades, there was little indication that this strategy was working. But after the turn of the millennium, with the emergence of new Asian growth drivers and favourable movements in the terms of trade, economic growth began to accelerate. Some observers attributed this to the market-oriented policy reforms undertaken by a number of LDCs, though others raised doubts about their pattern of growth. Surging commodity prices, in some cases driven by speculative investment, debt forgiveness, increased aid flows, remittances and foreign direct investment (FDI) seemed vulnerable to a global economic downturn. There were also concerns that growth was not translating into substantial improvement in human well-being. When commodity prices suddenly fell at the end of 2008, heralding a bust in the global economic cycle, many LDCs experienced a sharp slowdown, with major adverse social consequences. It was clear from this that markets are not only creative but also can be destructive.

As discussed in previous *LDC Reports*, the LDCs have remained marginal in the world economy owing to their structural weaknesses and the form of their integration into the global economy. Unless both these aspects are directly addressed, they will remain marginal and their vulnerability to external shocks and pressures will persist. Unfortunately, existing special international support measures for LDCs do not effectively address the structural weaknesses of these countries or how the LDCs interact with the global economic system. Therefore it is hardly surprising that during the past three decades only two countries were able to graduate from the LDC status and in fact the number of countries falling in the LDC category has doubled.

The basic message of this Report is that for achieving accelerated development and poverty reduction in LDCs, there is need not only for improved international support mechanisms (ISMs) which are specifically targeted at the LDCs but also for a new international development architecture (NIDA) for the LDCs. The NIDA for LDCs is defined as a new set of formal and informal institutions, rules and norms, including incentives, standards and

processes, which would shape international economic relations in a way that is conducive to sustained and inclusive development in LDCs. This includes reforms of the global economic regimes which directly affect development and poverty reduction in LDCs, as well as the design of a new generation of special international support mechanisms for the LDCs that would address their specific structural constraints and vulnerabilities. In addition, given the increasing importance of South-South flows of trade, FDI, official finance and knowledge, South-South development cooperation, both within regions and between LDCs and large, fast-growing developing countries, should play an important role in the proposed NIDA for LDCs. Such cooperation should also include some ISMs for LDCs.

The Report proposes five major pillars for the NIDA: finance, trade, commodities, technology, and climate change adaptation and mitigation. At present, the focus of support for LDCs is mainly in the area of trade. The Report argues that there is need for more and new forms of financial assistance to support domestic resource mobilization and the emergence of a profit-investment nexus in the LDCs involving the domestic private sector. Technology and commodities, which at present are neglected issues, should be among the core pillars of the new architecture for LDCs. Climate change adaptation and mitigation should also be made a new priority. Development partners need to enhance coherence between the different domains of the international architecture, particularly between trade and finance, and they also need to honour their commitments to ensure that the interests of the LDCs themselves are taken into account in these areas.

The term "international support mechanism" (ISM) is used in this Report, rather than "international support measure", to convey the idea that providing special international support for LDCs is not simply a matter of designing new policy measures but also ensuring the financial and institutional means through which these measures are implemented. The Report shows that existing international support measures have had largely symbolic, rather than practical, development effects. They do not address the structural weaknesses of the LDCs. This is partly because of the way they are designed, often containing exclusions that reduce the commercial benefits of the measures, and partly because of inadequate or inappropriate institutional mechanisms and financing for implementation. Moreover, there are different interpretations of what they mean. The Report calls for a new generation of LDC-specific international support mechanisms that should be accompanied by resources, including

financial resources, institutions, policy frameworks and organizational entities, to enable their implementation. This new generation of ISMs should also move beyond a focus on trade and in particular market access, to promote development of productive capacities in LDCs. Only then can the ISMs be actionable and potentially address the specific structural weaknesses and vulnerabilities of LDC economies today, including: weak human resources, poor physical infrastructure, low technological capabilities, excessive dependence on external sources of growth, low share of manufacturing in GDP and high levels of debt.

However, although a new generation of special ISMs targeted at LDCs is essential, it is not enough. This is because these special mechanisms have to work within a general framework of rules, norms, standards, practices and understandings which guide the international economic and trade relations of all developing countries, including the LDCs and sub-categories of developing countries (such as "low-income countries", "heavily-indebted poor countries" and "fragile States") which imperfectly overlap with the category of LDC. This general framework includes, for example, a very weak global governance regime for private financial flows, a strictly defined aid architecture and debt relief regime, currently accepted practices in the provision of agricultural subsidies in rich countries, and an increasingly stringent intellectual property rights (IPR) regime for developing countries. At the same time, there is neither an effective international commodity regime nor a regime for encouraging technology transfer. All these add up to a global environment that is not conducive to sustainable, inclusive development. Given the weaknesses in the design and implementation of existing special international support measures for LDCs, these general regimes now exert a greater impact on development and poverty reduction in the LDCs than the special measures. Broader systemic reforms are therefore necessary, and the ISMs will only be effective if they are embedded within a more general policy framework as represented by the NIDA for LDCs.

The objectives of the proposed NIDA for LDCs are to: (a) reverse the marginalization of LDCs in the global economy and help them in their catching up efforts; (b) support a pattern of accelerated and sustained economic growth which would improve the general welfare and well-being of all people in LDCs; and (c) help LDCs graduate from LDC status. The Report argues that these objectives can be achieved if there is a paradigm shift towards supporting new, more inclusive development paths in LDCs. This requires the State to

play a more developmental role in creating favourable conditions for capital accumulation, technological progress and structural transformation, as well as in the generation of productive employment opportunities, which is the key to substantial poverty reduction in the LDCs.

A perceptible shift in development thinking has been occurring over the past decade, and particularly since the global financial and economic crisis, with an increasing search for a new post-Washington Consensus development paradigm. The design of the NIDA is based on an emerging development paradigm, elaborated by UNCTAD, which gives priority to the development of productive capacities. It advocates a hybrid economic development model based on a balanced mix of private and public domains and interests. In the wake of the global financial crisis, which demonstrated clearly the dangers of dependence on the market system, there is a need to shift away from market fundamentalism. The principal elements of the new development paradigm include: enlarging the scope for greater ownership of development policy; empowering Governments to enable them to assume stewardship of strategies for building their domestic productive capacity and mobilizing domestic resources; and placing greater emphasis on sustained poverty reduction, distributional equity and productive capacity through the building of developmental States. Recommended global economic reforms and new ISMs should flow from and reinforce this new paradigm.

The new paradigm no longer gives priority to the private sector and market forces at the expense of the public sector and the role of the State, nor to trade over production. Moreover, it aspires to address the root causes of poverty, rather than only treating the symptoms of poverty and underdevelopment. However, poverty reduction is not treated as a goal per se; rather it is considered in relation to other elements of the development strategy, notably country ownership, structural change, capital accumulation and the developmental State. In this context, efforts to advance achievement of the Millennium Development Goals (MDGs) through policy changes at the national level also require supportive international actions.

A major lesson emerging from the global financial and economic crisis and the subsequent policy response is that global economic reforms are necessary for achieving more stable and sustained global prosperity. Global income inequality is closely related to the global imbalances that have been directly implicated in the crisis. These imbalances need to be addressed in the systemic

reforms designed to reduce overall economic volatility and to ensure that finance is directed more to the real economy than to the speculative leveraging of financial assets. The NIDA for LDCs should be a part of this broader set of systemic reforms that need to be taken in the wake of the financial crisis and global recession, which would be beneficial for all countries, both developed and developing.

Thus the new generation of special ISMs for LDCs should be located and contextualized as part of a larger agenda that includes reforming global governance and enhancing the effectiveness of the international development architecture for all developing countries. Marrying international support mechanisms for LDCs with a new international policy and cooperation framework that can deliver a more stable, equitable and inclusive global governance regime for all countries is one of the most urgent challenges facing the international community today. Doing so will not only help make special international support for LDCs more effective, it will also contribute to mainstreaming LDC issues into a wider development agenda.

## THE BOOM-BUST EXPERIENCE OF LDCS OVER THE PAST DECADE

### The fragility of the economic boom of 2000–2007

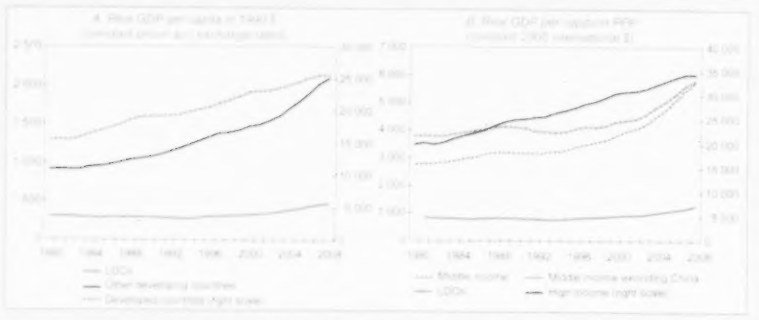
During the period 2002–2007, the real gross domestic product (GDP) of he LDCs as a group grew by more than 7 per cent per annum. This was the rongest and longest growth acceleration achieved by this group of countries nce 1970, and a much better overall macroeconomic performance than in e 1990s. However, not all LDCs experienced a boom: a little over a quarter the LDCs (14 countries) saw GDP per capita decline or grow sluggishly. oreover, because of the high rate of population growth in the LDCs, the per pita GDP growth rate, which matters more for human well-being, remained ghtly lower than that of other developing countries. Nevertheless, over this oom period the target growth rate of the Brussels Programme of Action for the ast Developed Countries for the Decade 2001–2010 (BPOA) was achieved the LDCs as a group and also in 16 LDCs.

The economic boom was driven by record levels of exports, FDI inflows and migrants' remittances, although these were unevenly distributed amongst the LDCs. Rising commodity prices, particularly for oil and minerals, were particularly important as a driver of GDP growth. But the economic boom in the LDCs was systemically unsustainable because it was founded on a pattern of global expansion that was leading to increasing global imbalances, widening income inequality and rising levels of private debt without a concomitant development of real assets. The pattern of economic growth in LDCs was increasingly exposing them to economic shocks, and it was not associated with substantial poverty reduction and strong progress towards realizing the MDGs. Using new poverty estimates specially prepared for this Report, it is apparent that over 50 per cent of the population of the LDCs still lived in extreme poverty at the end of the boom period. Moreover, these estimates also suggest that the number of extremely poor people living in LDCs actually increased by over 3 million per year during the 2002–2007 period of high GDP growth rates.

With the kinds of national policies pursued in the 2000s, the LDCs were unable to make the most of the opportunities presented by the boom. In particular, they were unable to promote a pattern of catch-up growth based on the development of productive capacities which would increase the resilience of their economies and set them on a more inclusive growth path. From a long-term perspective, the LDCs have historically experienced high growth volatility. After the prolonged decline of the 1980s and early 1990s, the LDCs started the new millennium with approximately the same level of real per capita income that they had in 1970. Since then, although their per capita GDP has increased significantly in real terms, the gap with other developing countries has continued to widen (charts A and B).

The export-led growth model, which implicitly or explicitly underpinned most LDCs' development strategies during this period, did not result in much of an increase in investment and capital formation in many of them. These countries also became more vulnerable to a global slowdown as their commodity dependence, export concentration and food imports increased. The export-led growth model was also associated with growing sectoral imbalances, as agricultural productivity lagged far behind the expansion of exports and GDP. This mounting disproportion has led to rising food import bills, and has had significant negative consequences for both the robustness and inclusiveness of their development path.

**GDP per capita in LDCs and other country groups, 1980–2008**



Source: UNCTAD Secretariat calculations, based on UNCTAD's *GlobStat* (panel A) and World Bank, *World Development Indicators* online database (Panel B).

The problem of LDCs' weak development of productive capacities during the economic boom and their increasing vulnerability to a global growth slowdown may be illustrated with a few facts.

- The unprecedented period of economic growth brought only limited improvements in LDCs' chronic shortfall of investment. Investment in the LDCs as a group grew from 20 per cent of GDP in 2000 to 23 per cent in 2008. Gross fixed capital formation actually fell in 19 LDCs during the boom years of 2002-2007.
- Domestic savings in the LDCs, excluding oil exporters, have remained constant at a very low level of 10 per cent of GDP.
- If savings are adjusted for depletion of stocks of fossil fuels, minerals and other forms of environmental capital, they are seen to have declined over the economic boom period, so that adjusted net savings were close to zero in 2008.
- The manufacturing sector accounted for 10 per cent of GDP in the period 2006–2008, the same level as at the start of the boom. Twenty-seven LDCs experienced deindustrialization (reflected in the declining share of manufacturing value added in their GDP) between 2000 and 2008.
- Imports of machinery and equipment, which are a major source of technological development and capital formation, increased only marginally in all LDCs, except the oil exporters, during the boom years.

- Agricultural value added per worker has grown at a third of the rate of GDP per worker in LDCs over the past 20 years, and this gap widened during the boom period.
- Cereal yields in the LDCs have increased only marginally over the past 20 years, including during the boom years, and at a much slower rate than the world average.
- The share of fuel and minerals increased from 43 per cent to 67 per cent of LDCs' total merchandise exports between 2000 and 2007. Dependence on a few export goods, particularly primary commodities, increased during the boom period in many LDCs, and export concentration also increased.
- LDCs' dependence on food imports increased markedly during the boom years, from US$7.6 billion in 2000 to US$24.8 billion in 2008.

In short, economic growth during the boom period in the LDCs was not underpinned by the development of productive capacities. Rather, the LDCs became even more vulnerable to external shocks, as their export concentration, dependence on commodities and external resources increased. UNCTAD's *LDC Report 2008* warned that the growth process in these countries was very fragile and unlikely to be sustainable — a judgment that is supported by recent events.

## The pattern of the bust during 2008–2009

When the global economy fell into the deepest recession since the Great Depression of the 1930s, the LDCs as a group also experienced a sharp economic slowdown. The immediate impact of the crisis was transmitted through financial markets, although this was relatively muted in most, but not all, LDCs. The contagion effects of the global crisis on LDCs were transmitted mainly through trade-related channels: the sharp and synchronized fall of commodity prices, combined with the decline in global demand, led to a rapid deterioration in export revenues, particularly for oil and mineral exporters. The services sector (mainly tourism and maritime transport) was also hit particularly hard by the crisis, with severe consequences for island LDCs. Generally, while LDCs' exports rebounded in mid-2009, sustained by an upturn in commodity prices, they are still well below their pre-crisis levels. In addition, FDI inflows to LDCs declined sharply in the wake of the global crisis. Angola, Democratic

Republic of the Congo, Central African Republic, Guinea and Madagascar, which had previously attracted considerable inflows of natural-resource-seeking FDI, were particularly hard hit.

Despite the slowdown, the LDCs as a group actually achieved a higher average GDP growth rate than either the group of other developing countries (ODCs) or developed countries in 2009. But this *LDC Report* argues that the apparent economic resilience of the LDCs during the crisis can be largely attributed to a number of external factors. Notably, in 2009 there was a substantial increase in assistance from the International Monetary Fund (IMF), the World Bank and regional development banks, which partly offset the decline in private capital flows. In addition, international commodity prices recovered during the year, associated mainly with growing demand from large emerging economies. LDC exporters of low-end manufactures have benefited from the growing demand for these products during the recession. Finally, workers' remittances to the LDCs that are the most dependent on them continued unabated.

The analysis in this Report suggests that the medium-term outlook for LDCs is fraught with major risks. Generally, the recent increase in official lending by multilateral development banks has tended to rely on bringing forward the funding which had been programmed for delivery over a longer period. In addition, as donors have been striving to adopt adequate countercyclical responses to the crisis, the increase in development assistance has strained their financial resources. Current projections by the Organisation for Economic Co-operation and Development (OECD) of donors' forward spending plans indicate only a marginal increase in country programmable aid for LDCs in 2010 and 2011. Thus, as the joint World Bank/IMF *Global Monitoring Report* 2010 states, "[a]bsent increased resources, these essential steps to provide desperately needed resources at the height of the crisis will imply a substantial shortfall in concessional financing over the next couple of years". In addition, 20 LDCs remain in a situation of debt distress, or at high risk of debt distress, while debt vulnerabilities are likely to worsen in the wake of the global crisis. Against this background, it is not surprising that existing economic forecasts estimate that, while the slowdown in LDCs in 2009 was less acute than in other developing countries, the recovery in 2010 will be slower. Indeed their economic recovery is expected to be the weakest of all country groups. It will depend particularly on whether the global recovery is sustained, and whether official development assistance (ODA) continues to be provided in a way that boost investment and maintain consumption per capita.

## Poverty trends and progress towards the MDGs

Economic growth in the LDCs has been very fragile; moreover, it has not been inclusive. This is basically because the LDCs have not been able to generate sufficient productive jobs and livelihoods for the growing number of people entering the labour force each year — even during the boom years. The employment challenge is closely related to the pattern of structural change. The LDCs generally have very high population growth rates, and consequently the number of young people entering the labour market is increasing each year. Agriculture typically employs a large proportion of the labour force in LDCs, but agricultural productivity remains very low, and farms are small, with the result that living standards for most peasants tend to be at or near subsistence levels. The ability of the sector to absorb labour is decreasing owing to smaller farm sizes and lack of investment and many people are forced to cultivate more ecologically fragile land. As a result, more and more people are seeking work outside agriculture, but the manufacturing and services sectors in most LDCs have not been able to generate sufficient productive employment opportunities for the young population. The non-manufacturing industries whose contribution to GDP has grown the most tend to be capital-intensive rather than labour-intensive. Thus the majority of young people are finding work in informal activities, most of which are characterized by low capital accumulation and limited productivity, and hence offer little scope for economic growth.

This Report presents a new set of poverty estimates for 33 LDCs in order to analyse poverty trends. The main feature that becomes apparent from the analysis is the all-pervasive and persistent nature of mass poverty in LDCs. In 2007, 53 per cent of the population of LDCs was living in extreme poverty (i.e. on less than $1.25 a day), and 78 per cent was living on less than $2 a day. Extrapolating this to all the LDCs shows that there were 421 million people living in extreme poverty in these countries that year. Moreover, the incidence of extreme poverty — the percentage of the total population living below the poverty line of $1.25 per day — was significantly higher in African LDCs, at 59 per cent, than in Asian LDCs, at 41 per cent. For the $2/day poverty line, however, the difference is less marked: 80 per cent in African LDCs and 72 per cent in Asian LDCs.

Overall, the poverty trends in the LDCs fall into three major periods between 1980 and 2007. From the 1980s to the mid-1990s, the incidence of poverty was on the rise in both African and Asian LDCs. Between 1994

d 2000, headcount rates began to decline, with the reduction accelerating ter 2000. But with rapidly rising populations, the number of people living extreme poverty in LDCs has continued to increase throughout the past 30 ars, including during the boom years, and by 2007 it was twice as high as in 90. Indeed, the number of extremely poor people living in the LDCs actually ntinued to grow during the period of economic boom. There is, nonetheless, significant difference between African LDCs, where the number of people ing in extreme poverty continued to rise, and Asian LDCs, where the trend ached a plateau after 2000.

Progress towards MDG achievement has also been slow. For MDG 1, this evident in both World Bank estimates and UNCTAD estimates presented ere. According to the World Bank, the incidence of extreme poverty in LDCs ll from 63 per cent in 1990 to 53 per cent in 2005, with two thirds of the nprovement or urring since 2000. The new poverty estimates suggest that e incidence of poverty in1990 was slightly lower (58 per cent), but progress nce 2000 has been slower, with a decline from 59 to 53 per cent over a ven-year period. These latter data imply that the poverty reduction deficit in DCs in relation to the MDG target is not only due to the increasing incidence poverty in the early 1990s and the slow rate of poverty reduction in the late 90s, but also to the slow rate of poverty reduction over the past decade.

Turning to the other six human development indicators for which progress wards specific time-bound MDG targets can be monitored, the following ends are clear:

- Regarding the target for universal primary education, both LDCs and developing countries are only slightly off track owing to a significant acceleration of enrolments since 2000. However, only 59 per cent of children in LDCs who start grade 1 reach the last grade of primary school, compared with 87 per cent in all developing countries.
- Concerning access to safe water, developing countries are on track to achieve the goal, but LDCs as a group are off track. There has been no significant change in the trend of increasing access to improved water sources in LDCs since 2000.
- Both developing countries and LDCs are off track in the rate of progress towards the target of reducing infant mortality and child mortality by two thirds between 1990 and 2015, though the rate is actually faster in LDCs

than in developing countries. However, because the former started from a very high level of mortality rates, overall they will fall far shorter of the target by 2015. There is no sign that there has been an acceleration of progress since 2000.

- Regarding access to improved sanitation facilities, both developing countries and LDCs are off track, but the rate of progress in LDCs is slower, with no significant acceleration since 2000.
- Regarding the maternal mortality rate, both LDCs and developing countries have made very slow progress.

The acceleration of growth in the LDCs during the economic boom period has led to some progress towards the MDGs and poverty reduction since 2000. However, in general the level of human development indicators remains appallingly low: for most indicators LDCs are where other developing countries were 20 years ago. A more disaggregated picture for LDCs shows that only a handful of countries are on track to achieve the MDGs on a broad front. There has been significant progress in net primary enrolment rates and gender parity in primary education, reflecting strong Government and donor commitment. Poverty reduction has also advanced to some extent. However these achievements are rather modest in relation to policy targets. Most notably, the acceleration of growth in LDCs in the early and mid-2000s appears to have had little impact on employment creation and overcoming food insecurity. Finally, in the crucial areas of quality and outreach of health services (MDGs 4 and 5) progress has been sluggish, as also for major infrastructural investments, including improving sanitation.

These data do not include the social impact of the crisis because only a few country studies on this issue have been conducted so far. From the limited data available, the crisis appears to have had significant negative social impacts in some LDCs. For example, it is estimated that there are an additional 2 million people living in extreme poverty in Bangladesh due to the crisis, even though this country was not too badly affected in terms of its macroeconomic performance. If the global economic crisis has more lasting effects in LDCs and the rather bleak medium-term outlook turns out to be accurate, even the modest achievements in poverty reduction between 2000 and 2007 will be jeopardized and the number of people living in extreme poverty in LDCs will certainly rise. Indeed, if poverty reduction rates over the next five years fall to those of the 1990s, there could be 77 million more people living in extreme

verty in the LDCs by 2015 than if the poverty reduction rates of the period 00–2007 were to be maintained.

## CHALLENGES AND OPPORTUNITIES IN THE COMING DECADE

### Policy scenarios for 2011–2020

The main policy objective for LDCs remains substantially higher and ainable growth rates that will allow them to catch up at least with middle- ome countries in coming decades and substantially reduce poverty. With in mind, the Report presents several economic scenarios for LDCs in the ade 2011–2020, using the Global Policy Model developed by the United ions Department for Economic and Social Affairs (UN-DESA) and adapted UNCTAD to provide more detailed information on the LDCs.

n the model simulations, an ambitious objective is set for accelerated vth of income in each of four groups of LDCs (African energy exporters, gladesh, other Asian and Pacific LDCs and other African LDCs plus Haiti), eby allowing LDC-specific scenarios and policy simulations. The stated cy objective is a 2 per cent improvement in growth of income per capita ng the period 2011–2015 relative to the past decade (2000–2010) and a her 2 per cent acceleration over the period 2016–2020. This would bring long-term per capita income growth rate to 9 per cent per annum for an energy exporters, 8.5 per cent for Bangladesh, 10 per cent for other n LDCs and 7 per cent for other African LDCs. These objectives for LDCs pare with an expected average per capita income growth rate of about 4 cent in the world as a whole and 2–3 per cent in high-income countries.

he achievement of these targets would be in line with the Spirit of terrey Declaration made by the Heads of State at a retreat during the ed Nations International Conference on Financing for Development in terrey on 18–23 March 2002, which stated: "We undertake to assist the d's poorest countries to double the size of their economies within a decade, der to achieve the MDGs." Although this would represent a breakthrough

compared with the period 1971–2000, income per capita in 2020 would still remain below $3,000 in most LDCs and below $1,500 in non-energy-exporting African LDCs.

Four simulations were calculated for four different types of policies which could be chosen by the LDCs as a means of improving living standards and accelerating economic growth. These four scenarios are:

Scenario 1: Accelerated growth of government spending on goods and services

Scenario 2: Accelerated infrastructure investment, both public and private

Scenario 3: Export expansion and diversification

Scenario 4: A dynamic export-investment nexus

The baseline projection presents a rather optimistic view of global developments in the coming decade which implies a quick and sustained recovery. This should provide an opportunity for substantial improvements in LDCs. According to the baseline projections for LDCs, which assume this favourable global context and development policies similar to those followed in the past, African energy exporters and Bangladesh are projected to grow as fast, or faster, than other parts of the world, permitting their per capita income to grow at an average annual rate of about 5 per cent, which is significantly faster than the rate of growth expected in high-income countries. Even so, and despite some overall improvements in macroeconomic performance, average national income per capita in 2020, measured at around $3,400 (in 2000 purchasing power parity (PPP)) for African energy exporters and $2,300 for Bangladesh, will still be a small fraction of the average for the world as a whole ($12,800), and less than one tenth of the average for high-income countries ($35,700).

The baseline projections are less optimistic for other LDC groups. Exports of primary commodities and services are projected to grow more slowly in LDCs than in other parts of the world, implying that their average income levels will lag further behind. Other African LDCs are expected to perform particularly poorly owing to weak exports, high population growth rates and rising costs of oil imports. In these countries the average per capita income would increase very little, if at all, remaining at around $850, while government debt would remain at around 70 per cent of GDP. Net external positions are expected

o become increasingly negative, reaching nearly 90 per cent of GDP for the Other Asian LDCs and no less than 150 per cent of GDP for the Other African LDCs.

Not surprisingly, scenario 4 offers the most effective approach to accelerated growth of production and income through a combination of demand expansion government spending, infrastructure investment and export promotion), which should provide a broad range of development opportunities for public and private institutions in different regions of each country. The impact is projected o be somewhat weaker for African energy-exporting LDCs and Bangladesh, which have better baseline development prospects, and stronger for other Asian and African LDCs, for which baseline prospects are not so good. Policies of demand expansion and infrastructure investment should boost the average annual income growth rate by 0.4–0.8 per cent for Bangladesh and over 2 per cent for the other LDC groups, as compared with export promotion alone. Looking at the scenario the other way round, export promotion policies should boost the average annual GDP growth rate by 0.3–0.6 per cent in Bangladesh and by 0.5–1.5 per cent in the other LDC groups, as compared with policies focusing only on demand expansion and infrastructure investment. Although such policies entail significant domestic and external costs, the cumulative benefits for production, trade and government revenues generated by a consistent application of domestic policies over the medium term means that the policies will eventually finance themselves as government debt and external debt fall relative to GDP.

The findings indicate that it is feasible to accelerate growth in LDCs under alternative policy scenarios that include a much greater role for public investment and expenditure internally, buttressed by international policies. In all four scenarios, external constraints are significant. From a macroeconomic perspective, the most important functions of international policies to support the LDCs would be financial assistance aimed at increasing investment and developing export industries and export promotion, and grants to cover government budget deficits. From these scenarios, it is clear that a significant improvement in per capita income in LDCs over the coming decade will require substantial external assistance of this kind. Thus, making this external assistance effective will be a clear priority. On the other hand, austerity measures in developed countries in response to their own accumulated imbalances would almost certainly have a negative impact on most LDCs.

## New international factors

The policy scenarios are based on historical trends, but the outcomes over the coming decade will also be affected by new developments in the international economy. The Report examines two new international factors which are likely to significantly influence the potential for development and poverty reduction in the LDCs over the coming decade: (i) climate change and (ii) increasing South-South economic relations.

*Climate change*

Although the LDCs as a group contribute relatively little to global warming — accounting for less than 1 per cent of the world's total greenhouse gas (GHG) emissions — they will be disproportionately affected by changing climatic conditions. The majority of LDCs are located in regions already experiencing environmental stress. In addition, their economic weaknesses, including low levels of economic and human development, strong dependence on natural resources and climate-sensitive sectors as a source of local livelihoods and national income, render them particularly vulnerable to climate change and its catastrophic effects. It has been estimated, for example, that for every 1 °Celsius rise in average global temperatures, average annual growth in poor countries could drop by 2–3 percentage points, with no change in the growth performance of the developed countries.

The frequency and intensity of extreme weather events in LDCs (e.g. droughts, extreme temperature and floods) have been increasing, with five times as many such incidents occurring during the period 2000–2010 as during the period 1970–1979. The number of people in LDCs affected by these extreme events has almost doubled, rising from 100 million during the period 1970–1979 to 193 million over the period 2000–2010. During the latter period, economic losses in LDCs resulting from natural disasters amounted to an estimated $14.1 billion.

As a result of climate change, many African LDCs may experience greater rainfall, modifications in rainy season food crop production characteristics, shorter growing seasons and increased flooding. For other African LDCs, reduced rainfall may result in longer dry seasons, drought and unviable agricultural production in areas where subsistence farming might previously

have been practiced. Both scenarios will adversely affect their economies and food security in the absence of significant adaptation efforts.

Responding to the challenges of climate change in LDCs, including reorienting their economies towards more climate-resilient and ecologically sustainable growth paths, will require a significant injection of financial resources. These resources would have to be additional to those required to meet existing social and economic development needs to ensure that past, present and future gains in these areas are not compromised. It is unlikely that LDCs will be able to meet the financial costs of climate change adaptation and mitigation without substantial external contributions from the international community.

*New economic relationships with other developing countries*

Other developing countries (ODCs) that are not LDCs have increasingly become very important economic partners of LDCs in trade, investment, capital, and technology and development cooperation, especially since the 1990s. In some cases, South-South flows in these fields have begun to exceed North-South flows. This is particularly striking in the area of international trade. Traditionally, LDCs sourced one third of their imports from developing countries. This share started to increase sharply from 1991, and since 1996 more than half of LDCs' imports have originated in the South, reaching 62 per cent in 2007–2008. Between 1990–1991 and 2007–2008, developing countries accounted for 66 per cent of the expansion of LDCs' foreign trade. Regarding exports, traditionally developing countries absorbed between one fifth and one fourth of LDCs' total exports. This share started to increase in 1993, and by 2007–2008 developing countries as a group became the largest market for LDC exports, accounting for half of their total exports. The quicker growth of South-South trade of LDCs has meant the decline in the relative importance of trade with developed countries (especially members of the European Union).

The new South-South economic relationships are likely to strengthen further over the coming decade. This offers a major development opportunity for the LDCs, but realizing its potential will not be automatic.

A current shortcoming in LDCs' economic linkages with their major developing-country trading partners is that these trade and investment flows resemble those with developed countries, contributing to lock in LDCs as

exporters of commodities and labour-intensive manufactures and importers of a large array of manufactures. A major opportunity arising from South-South linkages and regional trade agreements (RTAs) is that they offer domestic firms in LDCs possibilities to learn how to operate internationally and achieve economies of scale. They also enable diversification of exports and entail lower adjustment costs than integration with developed countries. In addition, South-South regional integration enables the geographical diversification of trade, investment and official finance. Moreover, regional synergies can be created through joint investments in infrastructure projects and/or through the regional division of labour.

## Weaknesses in the current international economic architecture for LDCs

The design of a new international development architecture (NIDA) for the LDCs should build on a proper diagnosis of the current international economic architecture. The Report argues that the current architecture is not working effectively to promote development and poverty reduction in the LDCs and to reduce their marginalization and vulnerability in the world economy. It identifies two major weaknesses. First, although there has been an increasing recognition of the need for special international support mechanisms for LDCs over the past 15 years, and particularly in the area of international trade, the international support has thus far focused largely on measures that have symbolic significance rather than practical developmental impacts. Second, the development dimension in current global economic regimes is weak. The adoption of a one-size-fits-all approach has had particularly adverse consequences for the LDCs, given their very low level of development and structural weaknesses. There is also a lack of harmony between the existing global systemic regimes and the special international support measures for LDCs which can completely undermine both the intent and outcomes of the latter.

It is important to address both these sources of weakness when designing a NIDA for the LDCs. The Report points out that an exclusive focus on LDC-specific international support measures would be insufficient, as these measures work within a more general framework of rules, norms, practices and understandings which guide the international economic relations of all

eloping countries, including the LDCs and sub-categories of developing ntries, such as low-income countries.

## Weaknesses of the current international support measures

The Brussels Programme of Action (BPOA) for the LDCs for the Decade 01–2010 contains commitments to 156 actions to be taken by the LDCs and 5 actions to be taken by their development partners. However, the precise us of those actions is unclear. This Report focuses on eight international port measures which can be considered current best-case examples of tial international support measures in favour of LDCs. They are not only uded as actions in the BPOA, but also are being implemented or monitored ome form or other by various international organizations, such as OECD elopment Assistance Committee, the World Trade Organizations (WTO), United Nations Framework Convention on Climate Change (UNFCCC) or World Intellectual Property Organization (WIPO), or they form part of the G targets which have been the focus of efforts of the donor community the past decade. Thus, if the effects of these measures have been limited, nnot be explained by the simple fact that nothing has been done after yone has gone home following a verbal agreement at a global conference.

he eight specific measures are:

- ODA targets of 0.15 or 0.20 per cent of donor's gross national income (GNI) to be allocated to LDCs;
- 2001 DAC Recommendation to untie aid to LDCs;
- Special consideration given to LDCs in their accession to the WTO;
- Special and differential treatment (SDT) for LDCs in WTO agreements on goods and services;
- Preferential market access for LDCs;
- Article 66.2 of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement);
- The Integrated Framework for Trade-related Technical Cooperation (IF), which has now been succeeded by the Enhanced Integrated Framework (EIF); and

- The Least Developed Countries Fund (LDCF), established to implement the UNFCCC work programme.

Assessments of the effectiveness of these measures are based on existing published evaluations of how they have worked, but where the Report adds value to these evaluations is by juxtaposing them and comparing their findings. For example, there has been no comparison of the overall outcome of the IF and LDCF as they operate in different domains. However, a comparative assessment enables the identification of some common weaknesses.

The Report's comparative analysis shows that very little action has yet been taken on two of the eight measures listed above, namely SDT within WTO agreements, and the decision to facilitate WTO accession for LDCs while exercising restraint in seeking concessions in the accession process. With regard to the former, the failure to implement is due to LDCs choosing not to utilize the few opportunities of SDT which exist within the agreements. As for facilitating LDCs' accession to the WTO, on the contrary developed countries have sought concessions above and beyond those that were demanded of existing least developed country WTO members at the time of their accession negotiations.

Concerning the ODA target, it is unclear whether this is being implemented directly by donors or as a by-product of other aid allocation priorities. The econometric evidence shows that LDC status does not influence the geographical allocation of aid for the LDCs as a whole. There was progress towards the achievement of the aid target for LDCs during the period 2000–2008, as the aggregate ratio of aid to gross national income (GNI) of DAC member countries rose from 0.05 per cent of GNI in 2000 to 0.09 in 2008, reversing the downward trend in the 1990s. However, critically, if the lower ODA target of 0.15 per cent of GNI had been achieved, LDCs would have received $60.7 billion in aid rather than the $37 billion they actually did receive (i.e. a shortfall of $23.6 billion). The cumulative shortfall of aid inflows during the period 2000–2008 — a period when this goal was inscribed as one of the targets in MDG 8 — was actually higher than that in the 1990s, and the cumulative shortfall in aid during 2000–2008 in relation to the lower 0.15 target was equivalent to 51 per cent of the GNI of LDCs as a group in 2008.

With regard to trade preferences, this approach is based on four critical assumptions: that the markets in LDCs work (i.e. producers and consumers respond to market signals); that preferential market access will help LDCs

attract more foreing investment; that LDCs produce almost competitive exports; and that restricted market access poses major challenges for LDCs. These assumptions are highly questionable, since, as pointed out in previous *LDC Reports*, a major weakness in LDCs is their limited supply capacities that constrain their ability to respond to market opportunities. This means that market creation and market entry is as important as market access, if not more so. It highlights the need to build domestic productive capacity and enable domestic resource mobilization — a long-term effort which requires macroeconomic policies that encourage investment in productive sectors. Unfortunately, as empirical evidence indicates, countries that cannot export competitively cannot benefit from preferential market access.

There are various features of the design of some of these special measures which limit their development effectiveness from the outset. Of the seven measures, the scope of SDT for LDCs in WTO agreements is for the most part not oriented to provide development benefits, but rather to provide transitional arrangements for facilitating implementation of those agreements by the LDCs. The other measures aim at bringing some concrete trade and development benefits, but their effectiveness is limited by: (i) important exclusions, which are explicitly included in the design of the measures to protect commercial interests in the LDCs' development partners; and (ii) a failure to take account of the economic constraints within LDCs, which prevents these countries from grasping the opportunities created by the special measures.

An example of the exclusions is the initial aspiration to accord duty-free and quota-free (DFQF) market access preferences to only 97 per cent of product lines (rather than 100 per cent). This makes these preferences commercially meaningless, given that the remaining 3 per cent of products not covered may be precisely those that the LDCs are able to export. Another example is the exclusion of food aid and technical cooperation from the 2001 DAC Recommendation to untie aid. Moreover, economic weaknesses in LDCs limit their ability to utilize trade preferences and also the ability of domestic enterprises in LDCs to benefit from the untying of aid. In each of these cases, these constraints could be overcome by a better design of the support measures. For example, rules of origin, which enable more sourcing from other developing countries, or special efforts to reduce the contract size in aid provision and thus facilitate more local procurement, could considerably enhance the trade and development effects of these support measures.

Implementation in ways which could bring greater development benefits to LDCs has also been adversely affected by different interpretations of what a "special measure" actually means. There is a recurrent pattern of LDCs and their development partners having different expectations about what special measures should deliver. This is starkly illustrated by the interpretation of developed-country WTO members to Article 66.2, an interpretation which downplays that article's provision concerning incentives for enterprises and institutions in their territories to encourage technology transfer. In addition, there have been different understandings and expectations of what the whole IF process and the 2001 DAC Recommendation can deliver.

The development effects of the special measures for LDCs are also sometimes stymied by inertia in their implementation. This is evident, for example, in the way untying of aid actually works. Furthermore, increased technical assistance for the LDCs is often necessary to enable them to derive benefits from these measures, but it is either not provided, or not provided in a way which allows them to utilize the measures (for example, in relation to SDT in the international trade regime).

However, perhaps the most important area of breakdown in implementation relates to financing. For example, the financial flows which have followed from the Diagnostic Trade Integration Study (DTIS) and the national adaptation programmes of action (NAPAs) have fallen far short of needs. The total amount allocated to LDCs through the IF process between 2000 and 2010 was, on average, little more than $1 million per LDC, and the LDCF disbursed $4 million per LDC (in 32 countries) to support climate change adaptation projects between 2001 and June 2010. Similarly, TRIPS Article 66.2 has been implemented in such a way that rather than offering financial incentives for technology transfer, existing activities have simply been reclassified which could — at a stretch of the imagination — be said to fall within the ambit of that Article. The lack of funding for the LDC-specific international support measures contrasts markedly with the United Nations system's expenditure on operational activities which has been increaslingly focused on LDCs.

Instead of the needed financial assistance, what the LDCs often get out of these international support measures is studies and monitoring mechanisms. All five measures — Article 66.2, preferential market access (within the MDGs), the 2001 DAC Recommendation, the LDCF within the UNFCC and its associated expert group, and the EIF — have monitoring mechanisms. This has led to better

data, for example with regard to reporting of the percentage of tied aid or the percentage of imports that enter duty free into developed countries. Developed countries now also regularly report on what they are doing in relation to TRIPS Article 66.2. One of the most important outputs of the special mechanisms has been studies which could lead to projects and programmes. This has been the major outcome of both the IF, which has produced 38 Diagnostic Trade Integration Studies (DTIS), and the LDC Fund under which 43 NAPAs have been prepared and 48 LDCs have received funding for their preparation. But without the funds and institutions to follow through beyond monitoring, the value of all this work is either lost or becoming obsolete.

A positive feature arising from the comparison of the effectiveness of the various international support measures for LDCs is that there is clearly a learning process occurring. This is perhaps most apparent in relation to the Integrated Framework, which, since 1997, has been first improved and then enhanced. It is also apparent in the design of market access preferences. However, from an LDC point of view, this learning process has been painfully slow. It has taken 13 years to get the IF initiative in shape. Moreover, the major difficulties affecting the utilization of market access preferences by LDCs were known 40 years ago, and indeed it was precisely these difficulties which provided the rationale for designing special forms of preferences for the least developed amongst the developing countries.

Overall, existing special international support measures do not work in a way that is developmentally effective, either because of their inappropriate design or the manner in which they are implemented. The nature of these measures reflects the weak bargaining power of LDCs, so that they are forced to accept what they are offered. The commercial interests of rich countries and wide differences in interpretation between LDCs and their development partners also continue to stymie their effective implementation. It is clear that there is a learning process in the design and implementation of the special measures, and during the last decade there has been important progress in ensuring that those measures are multilaterally agreed and monitored. But the learning process has been painfully slow and there is need now to accelerate their improvement and orientation in order for them to yield genuine development results.

The Report does nevertheless show that the LDCs are benefiting from affirmative action throughout the United Nations system. According to the most recent estimates, the United Nations system's expenditures on operational

activities for LDCs increased from $2.4 billion in 2000 to $7 billion in 2008. This represents an increase from 28 per cent of total expenditures to 38 per cent, both for developmental and humanitarian operational activities. It is also estimated that more than 50 per cent of country-level expenditure in 2008 went to LDCs, up from 39 per cent in 2003. But it is necessary now for wider recognition of the LDC status in the overall international development architecture.

## Weaknesses in the current global economic regimes

The Report identifies four major weaknesses in the current global economic regimes from an LDC perspective.

First, the structural weaknesses of the LDCs imply that the global economic regimes which constrain or enable development and poverty reduction in developing countries in general (including the LDCs) do not work as expected in an LDC context. The evidence used to justify the national and international policies and practices associated with these regimes is usually drawn from the more advanced developing countries, where data are more readily available. These frameworks are, by definition, not designed in a way that specifically addresses the structural weaknesses of LDCs. Policies and practices that could work in one context are therefore often inappropriate in the LDC context. They do not produce the expected outcomes, and indeed they can often hinder the achievement of desired development and poverty reduction objectives. In short, failures have arisen from the application of models for finance, trade and technology that are not appropriate to address the structural weaknesses and structural vulnerabilities of the LDCs. Such a one-size-fits-all approach has been particularly damaging for the LDCs.

Second, there are certain aspects of the global economic regimes which are very important to LDCs because of their stage of development and their form of integration into the global economy, but which are missing from the overall international development architecture. From an LDC perspective, a major element missing from the global economic regimes is the lack of an international commodity policy. Such a policy is particularly important for many commodity-dependent LDCs, because the way in which commodity markets behave and the increasing interdependence between these markets and financial markets is integrally associated with the boom-bust nature of the

growth experience of the LDCs and their structural constraints. It also has a bearing on the interrelationship between the food, financial and climate crises and their effects on the LDCs.

Third, inappropriate models have been propagated through conditionalities and micro-incentives that encourage compliance. These have undermined country ownership of national development strategies and limited policy space. The inadequacy of the one-size-fits-all approach to development is being increasingly recognized, resulting in the advocacy of a more context-specific approach to development based on country ownership. Theoretically, this should allow greater recognition of the specific structural weaknesses and vulnerabilities of the LDCs. There have already been major changes in the practice of policy conditionality, and countries have assumed a greater role in the design and implementation of their Poverty Reduction Strategy Papers (PRSPs). But the evidence shows that the way in which PRSPs are designed and implemented is still strongly influenced by donors' policy conditionality, monitoring benchmarks and financing choices. It is also proving very difficult to realize the potential of national leadership in the design and implementation of national development strategies in most LDCs because of their weak technical capabilities and a certain reluctance on the part of the LDC Governments themselves to experiment. They fear that the adoption of policies deemed inappropriate by donors could adversely affect their access to external finance. Thus, learning and experimentation in policymaking and greater domestic ownership of policies is proving to be a very slow evolutionary process.

Fourth, there is a lack of policy coherence between the different components of the global regimes, and in particular between the global regimes and special international support measures for the LDCs.

## Lack of policy coherence

The way in which the international economic architecture affects the LDCs is the product of the interaction of systemic regimes, special international support measures for the LDCs and measures designed for other sets of countries which overlap imperfectly with the LDC category. In general, the global economic regimes have had much stronger effects on LDCs than the special international support measures. Moreover, the systemic regimes and special international

support measures work at cross purposes. This is best illustrated by the following three examples.

The first example is the relationship between the LDC-specific development goals inscribed in the Brussels Programme of Action, on the one hand, and the MDGs on the other. The BPOA was drafted, negotiated and agreed after the Millennium Declaration but before the inter-agency agreement on the precise statistical targets which would be monitored to measure progress towards the MDGs. The BPOA was inspired by the Millennium Declaration and it also represented an attempt to renew emphasis on the partnership principle as a cornerstone of international development cooperation which had emerged at the end of the 1990s. One of the main aims of the BPOA, in contrast to earlier programmes of action, was to include quantitative, measurable goals and targets. To this end, the BPOA drew upon the agreed outcomes of the major international conferences of the 1990s in much the same way as the statistical specifications for the MDGs. But because the latter process occurred after the former, and because the former was a political negotiation, there is an overall mismatch and imperfect fit between the goals and targets of the BPOA and the MDGs. In some ways, the BPOA goals are more advanced than the MDGs as they include a mix of human development goals, particularly focusing on building health and education to build human capacities, and goals related to the development of productive capacities. Notably they contain growth targets, investment ratios and infrastructure development targets. However, in practice, it is the general development goals embodied in the MDGs rather than specific LDC development goals which have been the focus of attention. Certain BPOA goals have thus become important by default, that is to say, to the extent to which they conform to the MDGs, while other BPOA goals have been set aside by the international community.

A second example concerns mainstreaming trade in development strategies. This is an important goal of the IF process, but, as argued in earlier *LDC Reports*, the problem of trade mainstreaming is an issue of ownership. Yet there is limited country ownership of the macroeconomic framework in the poverty reduction strategies of the PRSP process. This macroeconomic framework contains forecasts of export and import growth, and the basic problem of integrating trade into national development strategies is that the trade objectives in the macroeconomic framework float freely, having no connection with the detailed trade objectives and policy measures contained in the main text of the PRSP. This disconnect arises because of the weak linkage

of the macroeconomic framework with the rest of the PRSP process, a state of affairs which sometimes is due to the framework being formulated by a narrow circle of officials, and other times, worse still, due to the fact that the trade forecasts are not locally generated. Whatever the cause, any special measure to integrate trade into poverty reduction strategies will not work so long as the general processes in the design and implementation of PRSPs undermine country ownership, and in particular if the processes which limit the ability of a county to exercise leadership in the design of the macroeconomic framework are not also addressed. In effect, the special measures and the systemic regime are working at cross-purposes.

The third example of the way special international support measures are embedded in a wider field of collective international action that is not LDC-specific is the Everything But Arms initiative of the European Union. This initiative played a very important symbolic role in catalysing action to give preferential market access to the LDCs. But its initial practical benefits were small. This was partly because, in terms of tariffs and quotas, the EU already had a relatively open trade regime for most LDC producers and many African LDCs already enjoyed market access preferences under the Cotonou Agreement.

What this implies is that if it were possible to design, agree and implement a new generation of more effective ISMs for LDCs, this in itself would not be enough to promote the goals of more sustained and inclusive development in these countries. For this to occur, the global economic regimes which are enabling or constraining development and poverty reduction in all developing countries, including the LDCs, would also have to support the same outcomes. To the extent that the general development architecture works against, or at least not in line with, the special needs and interests of the LDCs, the overall results would be neutral or even negative. In effect, the right hand (the general framework) would take away what was being given by the left hand (the special international support mechanisms). A necessary condition for making the special ISMs for LDCs effective is therefore not simply to improve them, but also to ensure that the global regimes affecting developing countries in general, including LDCs and the sub-categories within them which overlap with the LDCs, are also reformed so that they support development and poverty reduction in the LDCs.

## PILLARS, PRINCIPLES AND PROCESSES OF THE PROPOSED NIDA

As stated in the introduction to this overview, UNCTAD is calling for a new international development architecture (NIDA) for the LDCs to foster new, more inclusive development paths. The Report proposes a conceptual framework for the NIDA, including its objectives, the key principles which should inform its design and its major pillars. It also proposes key elements of a positive agenda for action in the creation of the NIDA, identifying priority areas. These are intended to be catalytic rather than exclusive.

Within both the global economic regimes and the South-South development cooperation framework, the Report identifies five major pillars which require reforms to constitute the NIDA. These are:

- The international financial architecture, including the aid and debt relief regime as well as regimes affecting private capital flows, both into LDCs by non-residents and out of LDCs by residents;
- The multilateral trade regime;
- An international commodity policy;
- An international knowledge architecture which enables access to, and use and generation of knowledge, including technology transfer and acquisition; and
- A regime for climate change adaptation and mitigation.

A new generation of special ISMs for the LDCs would be elaborated within each of these pillars. The resulting new architecture should thus be able to influence and shape economic behaviour of all agents operating in the domains of finance, trade, commodities, technology, and climate change adaptation and mitigation in order to achieve the basic objectives of the NIDA.

It is proposed that the overall design of the NIDA for LDCs be based on eight fundamental principles, as follows:

(i) Enable new, more inclusive development paths in LDCs based on the development of productive capacities, the associated expansion

of productive employment and improvement in the well-being of all people;

(ii) Foster and support country ownership of national development strategies and enhance the space for development policy;

(iii) Facilitate LDCs' strategic integration into the global economy in line with their development needs and capacities, including through a better balance between external and domestic sources of demand;

(iv) Redress the balance between the role of the market and the State. The State should play a more significant role in guiding, coordinating and stimulating the private sector towards the achievement of national development objectives;

(v) Promote greater domestic resource mobilization in LDCs with a view to reducing aid dependence;

(vi) Promote greater policy coherence between the different domains of trade, finance, technology, commodity and climate change mitigation and adaptation, and also between the global economic and trade regimes and the ISMs;

(vii) Support South-South cooperation as a strong complement to North-South cooperation;

(viii) Foster more democratic and universal participation in the global system of governance by giving greater voice and representation to LDCs.

A key feature of the proposed new architecture is an integrated policy approach which embeds international support mechanisms targeted at LDCs within both global economic regimes and South-South development cooperation. Some might argue that with the increasing differentiation of the world economy, the development dimension of global economic regimes should focus exclusively on the poorest countries, particularly the LDCs. However, this approach is analytically flawed and is rejected here, as there are major drawbacks to treating international support measures for LDCs as a substitute for systemic reforms.

Such a narrow approach would have unintended effects. Firstly, it is clear from the experience of the past 30 years that the problem is not just the weak growth performance of the poorest countries, but also the fact that some developing countries which are a slightly more advanced than the LDCs have

experienced growth failures which have pushed them down into the LDC group. Secondly, it is necessary to view the global development process in dynamic terms: if the more advanced developing countries are not able to deepen their industrialization and move up the technological ladder and out of the simple products being exported by the poorer countries, it will be difficult for the poorest countries to develop. As noted in the *LDC Report 2002*: "To the extent that the more advanced developing countries meet a glass ceiling which blocks their development, there will be increasing competition between the LDCs and other developing countries." In this situation, special ISMs for the LDCs could accelerate the graduation of some of these countries from the LDC category. However, at the same time, some other developing countries that are just above the LDC threshold might experience such weak economic performance as to risk entering the LDC category. Thus, although the special measures might provide benefits for some LDCs, their effect globally would be counterproductive.

The Report therefore advocates a mix of more developmental and coherent global economic regimes for *all* developing countries, including LDCs, along with special measures targeted to address the specific handicaps and vulnerabilities of the LDCs. As the more advanced developing countries move up the development ladder, LDCs could move into the production of goods and services that were formerly but can no longer be competitively produced in those more advanced developing countries. This process should be facilitated by South-South development cooperation aimed at reinforcing the mutually supportive economic relationships between the more advanced and the least developed developing countries.

Finally it is important for the LDCs to have a greater voice and representation in global governance. Although the Report does not deal with this issue, it is critical to the process of creating a NIDA for LDCs.

## AN AGENDA FOR ACTION TO CREATE A NIDA FOR LDCS

The creation of a new international development architecture for the LDCs requires comprehensive reforms in the areas of finance, trade, commodities,

technology and climate change. These should include: (i) systemic reforms of the global regimes governing these areas; (ii) the design of a new generation of ISMs for the LDCs, building on the lessons of the past; and (iii) enhanced South-South development cooperation in favour of LDCs. The main elements of an agenda for action, discussed in detail in the last three chapters of this Report, are presented below and summarized in the following table.

## Finance

Given LDCs' limited domestic financial resources, financing their development in a sustained and stable way is sometimes reduced to the question of the quantity and quality of aid. However, although the aid architecture remains important, the Report seeks to place the financing challenge within a broader framework. It focuses on two major areas for action which would contribute to the creation of the proposed NIDA: (i) the provision of resources for productive investment, particularly through the promotion of domestic financial resource mobilization, the creation of innovative sources of long-term development finance and innovative uses of aid to develop productive capacities, in addition to debt relief; and (ii) the promotion of country ownership and creation of policy space to help recipient countries mobilize and direct those resources in line with local conditions.

In this framework, aid certainly has an important role to play. Indeed, in the short and medium term there are major financing needs which can only be met through official financial flows. However, the major role of aid should not be humanitarian only, to alleviate the immediate suffering of people living in abject poverty; but it should also be developmental and should play a catalytic role in leveraging other forms of development finance. Thus aid should aim to promote greater domestic resource mobilization and the creation of an expanding investment-profits nexus which is embedded within LDCs based on the domestic private sector. This would also help LDCs to reduce their dependence on aid.

Priorities for systemic reforms in the global economic regime should include: (i) promoting domestic resource mobilization through increased aid for developing tax administration capability and financial deepening and with global financial and tax cooperation to reduce illicit capital flight and transfer pricing; (ii) promoting country ownership of national development strategies

## An agenda for action towards a New International Development Architecture for the least developed countries

| | Systemic Reforms in Global Economic Regimes | South-South Development Cooperation | LDC-specific International Support Mechanisms |
|---|---|---|---|
| Finance | • Promote domestic resource mobilization through<br>- Increased aid for developing tax administration capability and financial deepening<br>- Global financial and tax cooperation to reduce illicit capital flight and transfer pricing<br>• Promote country ownership of national development strategies<br>- Reform and reduce conditionalities<br>- Help rebuild developmental State capacities<br>• Enhance debt relief initiatives to address the continuing debt burden in many LDCs | • Scale up official financial flows, including by diversifying funding sources<br>• Expand debt relief by Southern creditors<br>• Regional financing schemes (funds, development banks, joint investment projects)<br>• Establish regional development corridors<br>• Create synergies between South-South and North-South official financial flows<br>• Developing countries in a position to do so to adopt minimum share for LDCs of their official financial flows<br>• Increase the developmental impact of South-South FDI through<br>- Home and host country measures and policies<br>- Multilateral financing of diversification projects | • Increase LDCs' access to development finance by meeting DAC-countries aid commitments (0.15-0.20% of GNI)<br>• Support better aid management policies in LDCs<br>• Devise innovative sources of funding for LDCs, including in particular SDRs allocation<br>• Increase share of aid for development of productive capacities through<br>- More aid for infrastructure and skills<br>- Innovative uses of aid, including new approaches to private sector development and PPPs, incentivizing FDI in infrastructure development |
| Trade | • Conclude the Doha Round giving central importance to the development outcomes for all developing countries<br>• Urgently implement the so-called "early harvest" without waiting for the completion of the Doha Round negotiations | • Deepen regional integration in South-South RTAs<br>• LDCs to develop a pro-active policy stance on South-South economic relations<br>• Foster regional trade through better information and trade facilitation<br>• Developing countries in a position to do so provide DFQF market access for LDC exports | • Enable LDCs to pursue strategic integration into global economy<br>• Empower LDCs to use all flexibilities provided under WTO rules<br>• Strengthen the special and differential treatment for LDCs<br>• Improve preferential market access for goods of LDCs, including 100 per cent DFQF by all developed countries<br>• Extend preferential market access for LDC services exports<br>• Simplify the accession of LDCs to the WTO<br>• Accelerate the provision of Aid for Trade through EIF |
| Commodities | • Establish a counter-cyclical financing facility for low income commodity-dependent countries to deal with external shocks<br>• Set up an innovative commodity price stabilization schemes, including physical and virtual reserves<br>• Establish transaction tax (multi-tier) for commodity-derivative markets<br>• Establish a counter-cyclical loan facility indexed to debtors' capacity to pay | | • Strengthen ability of LDCs to manage resource rents<br>• Technical and financial assistance to enable resource-based industrialization |

Table (contd.)

| | Systemic Reforms in Global Economic Regimes | South-South Development Cooperation | LDC-specific International Support Mechanisms |
|---|---|---|---|
| Technology | • Make the global IPR regime more development friendly by:<br>– Creating a balance between private and public dimensions of knowledge<br>– Supporting emergence of a new and coherent reality of technology transfer that complements domestic capabilities building<br>• Promote knowledge-intensive activities through mobilization of domestic resources<br>• Support the emergence of the learning-oriented developmental state that could facilitate knowledge based activities | • Share knowledge and experiences of industrial development strategies<br>• Set up regional R&D hubs<br>• Strengthen South-South cooperation on technology, including by providing finance on preferential terms for transfer of technology to LDCs | • Technology-sharing consortia<br>• Technology licence bank for LDCs<br>• The International Spark Initiative to promote enterprise innovation<br>• The LDC Talents Abroad Initiative to pool in the diaspora<br>• Provide IP-related technical assistance to LDCs that is comprehensive, coherent and development-focused<br>• Focus the technology transfer under Article 66.2 on expanding the reach of LDCs to technologies across the gamut of competencies in all sectors, accompanied by the know-how |
| Climate change | • Enhance the sustainability and predictability of climate change financing<br>• Develop accountable, transparent and representative climate finance governance | • Share knowledge and experience in mitigation and adaptation to climate change<br>• Strengthen South-South collaboration on renewable energy through technical cooperation, technology transfer, trade and investment | • Make UNFCCC a key pillar of predictable and equitable climate change finance framework for LDCs<br>• Replenish and reform LDC Fund<br>• Incorporate climate adaptation project preparation facility in LDC fund<br>• LDC-specific exceptions in mobilization of resources for climate change financing (e.g. Tuvalu proposal for differentiated taxation on international transport)<br>• Provide technical assistance to support implementation of REDD+ in LDCs<br>• Reform CDM to promote LDC access to renewable energy sector technology and finance<br>• Provide technical assistance to support LDC integration of climate adaptation and mitigation needs into national development plans |

*Source*: UNCTAD secretariat

through reform and reduction of conditionalities and helping to rebuild developmental State capacities; and (iii) the enhancement of current debt relief initiatives so that the debt overhang in 20 LDCs which are current in debt distress, or at risk of debt distress, is addressed.

In addition, a new generation of ISMs should include: (i) increasing LDCs' access to development finance by meeting DAC-countries aid commitments (0.15-0.20% of GNI); (ii) increasing share of aid for development of productive capacities through more aid for infrastructure and skills, innovative uses of aid, including new approaches to private sector development and PPPs incentivizing FDI in infrastructure development; (iii) supporting better aid management policies in LDCs, in particular through sharing experiences; and

(iv) devising innovative sources of funding for LDCs, including in particular SDRs allocation. The design of contingency financing and anti-shock facilities is an important issue for LDCs which is also discussed and taken up further under the commodities pillar.

## Trade

In the area of trade, it is clear that the successful conclusion of the Doha Round of multilateral trade negotiations under the aegis of the WTO which gives central importance to development outcomes for all developing countries would also benefit LDCs. In addition, the Report makes three major proposals. First, it supports the "early harvest" notion for LDCs, which was presented by LDC Trade Ministers in the context of the Doha Round negotiations. This includes, in particular, full implementation of DFQF market access for all products originating from all LDCs, in line with Decision 36 of Annex F of the Hong Kong WTO Ministerial Declaration, and a waiver decision on preferential and more favourable treatment for services and service suppliers in LDCs. The Report proposes that implementing these measures should not be made contingent on the completion of the Doha Round. Providing full DFQF market access for LDCs on all product lines is also part of Goal 8 of the MDGs, and its accelerated improvement would be an important aspect of strengthening the Global Partnership for Development between 2010 and 2015, even though it has been negotiated in the context of the WTO Doha Round. Secondly, LDCs should be empowered to use all the flexibilities already available under WTO rules to foster the development of their productive capacities and pursue their own form of strategic integration into the global economy. This will allow them to develop a new strategic trade policy to support their development and poverty reduction efforts in a manner compatible with the new post-crisis global macroeconomic environment. It would also enable them to take advantage of the new opportunities associated with South-South trade. However, to achieve all this they would need appropriate support. Thirdly, the EIF offers an important operational mechanism for ensuring that aid for trade development in the LDCs focuses on priority activities, and is integrated within national development and poverty reduction strategies. However, during the last decade, the flow of aid for trade, using the OECD statistical definition of this category, was increasing more slowly in LDCs than in other developing countries. A priority ISM for LDCs should be to accelerate that flow to LDCs, and ensure that it is directed at enhancing their productive capacities and international competitiveness in line

with the principle of country ownership. Trade-related capacity-building should be seen as part of the wider objective of developing LDCs' productive sectors and promoting the development of their private sectors. Thus, in addition to trade facilitation, it should include support for technological development and diversification out of commodity dependence.

## Commodities

In the area of commodities, the long-term goal should be structural transformation leading to more diversified economies. However, in the short and medium term, some new forms of international commodity policy are required.

Priority actions in the global economic regime could include the introduction of new measures for reducing the volatility of commodity markets and the adverse impacts of that volatility, such as:

(i) The establishment of a global countercyclical financing facility that ensures fast disbursement of aid at times of commodity price shocks, with low policy conditionality and high concessionary elements;

(ii) Setting up of innovative commodity price stabilization schemes, consisting of both physical and virtual reserve facilities;

(iii) Introduction of taxation measures to reduce speculation in global commodity markets; and

(iv) A counter-cyclical loan facility indexing repayment to debtors' capacity to pay.

The new generation of ISMs in the area of commodities should focus on various kinds of financial and technical assistance to enable greater local value added and linkages from resource-based diversification. These should include support to LDCs for improving the use of resource rents and avoiding Dutch disease effects, investment in improving knowledge of their natural resource potential, and the provision of technical assistance for LDC negotiations with transnational corporations (TNCs) to ensure that a greater proportion of the rents from natural resource exploitation accrue to the LDCs, and that those rents support resource-based industrialization.

## Technology

In the area of technology, the NIDA should focus on achieving a new balance between the private and public dimensions of knowledge. Knowledge is both a public good and a proprietary good (or quasi-private good), and includes features of both appropriability and exclusivity. The present global framework for technology issues is fragmented and incomplete, with a strong emphasis on proprietary knowledge in the form of intellectual property rights (IPRs). Within this framework, issues of technology transfer and knowledge accumulation – which are fundamental to improving productive capacities in LDCs – have been accorded secondary importance. The new knowledge architecture should focus on enabling a more development-friendly technology and IPR regime. It can do this by creating a balance between the public and private dimensions of knowledge and supporting the emergence of a new, coherent system of technology transfer that facilitates LDCs' domestic efforts to build innovative capacity. It should also strengthen LDCs' efforts to mobilize domestic resources to promote knowledge-intensive activities and encourage the emergence of a learning-oriented developmental State.

New forms of international public goods are required to counter the continued marginalization of LDCs in the acquisition and use of technologies, and also to achieve a gradual realignment of incentives provided under the global IPR regime. The Report makes specific proposals to make TRIPS Article 66.2 work for the LDCs. The Report also offers specific proposals for new ISMs for LDCs in the area of technology, as follows:

(i) Incentives for regional and national technology sharing consortia in LDCs;

(ii) A technology licence bank;

(iii) A multi-donor trust fund for financing enterprise innovation in LDCs; and

(iv) Diaspora networks to pool LDC talents from abroad.

These knowledge-based global public goods would help overcome some major limitations of the innovation environment in LDCs.

## Financing climate change adaptation and mitigation

The proposals concerning technology also apply to some of the international policies for climate change mitigation and adaptation. In addition, a critical priority at present is the establishment of an overall architecture for financing such mitigation and adaptation to increase the volume, predictability and sustainability of such financing. It is important for climate-change-related financing to be consistent with the United Nations Framework Convention on Climate Change (UNFCCC) and the Bali Action Plan which targets finance for the promotion of sustainable economic development. Specific ISMs for LDCs include: adequate financing of the LDC Fund (LDCF), increasing technical assistance to LDC for incorporating climate adaptation needs into their national development strategies, constructive engagement in helping LDCs to reduce emissions from deforestation and forest degradation (REDD), and improved access for LDCs to the Clean Development Mechanism (CDM) as a means of overcoming the financial barriers that prevent LDCs' access to renewable energy technology. The implementation and adoption of LDC proposals on transportation levies and carbon taxes, which call for various exceptions for LDCs, should also be supported.

## South-South development cooperation

South-South cooperation is a cross-cutting issue relating to all the pillars of the proposed NIDA. In general, the increasing integration of LDCs with some large and fast-growing economies (such as Brazil, China, India and South Africa — the so-called emerging economies), and to a lesser extent with ODC partners in regional trade agreements (RTAs) through trade, FDI, official development finance and knowledge-sharing can help LDCs develop their productive capacities. To this end, South-South economic relations need to foster domestic economic linkages, employment creation, technological learning, diversification and upgrading of output and exports, and the strengthening of State capacities. At present, this potential is being realized only to a limited extent — far below its possibilities. In order to fulfil the development potential of the evolving South-South economic relations, the Report proposes, firstly, the strengthening South-South development cooperation, by intensifying development cooperation activities and projects, sharing knowledge of successful alternative development strategies adopted by ODCs, improving the transparency of South-South development cooperation, and increasing the synergy between North-South

and South-South development cooperation; and secondly, deepening regional integration through RTAs in which LDCs participate, through measures taken by RTA partners and supported by large developing countries, developed-country donors and multilateral institutions.

The Report has also identified the following specific ISMs for consideration within South-South cooperation:

- Developing countries in a position to do so should set aside a minimum share of their official development finance for LDCs;
- Special mechanisms dedicated to LDCs should be established in South-South political forums (e.g. FOCAC);
- RTAs should adopt SDT measures to LDCs;
- Large and dynamic developing countries in a position to do so should offer DFQF market access to LDC exports;
- Large and dynamic developing countries should finance the transfer of their technologies to LDCs on preferential terms;
- South-South collaboration on renewable energy should be strengthened through technical cooperation, trade and investment.

In order to improve the development impact of these actions, LDC Governments need to formulate proactive strategies for their deeper economic integration with the other countries of the South. This should include enacting policies and adjusting rules and regulations to help steer this process to maximize its contribution to the development of their productive capacities.

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This Report proposes a conceptual framework and a forward-looking agenda for action to create a much more supportive international environment for the LDCs. The international community is meeting in Istanbul, from 29 May to 3 June 2011, for the Fourth United Nations Conference on LDCs. It needs to recognize the urgent need to move beyond business as usual, and enable and empower LDCs to adopt new development paths which will reduce their marginalization in the global economy and substantially reduce poverty. This Report presents an ambitious agenda of systemic reforms relevant for LDCs, and a new generation of international support mechanisms for the coming

decade. We must do better than in the past. One billion people will be living in the LDCs by 2017 and we cannot afford, for their sake and ours, to repeat the mistakes of the past.

Dr. Supachai Panitchpakdi
Secretary-General of UNCTAD

Printed at United Nations, Geneva
GE.10-52114–October 2010–8,045

**UNCTAD/LDC/2010(Overview)**